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C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 005951

SIPDIS

TREASURY FOR OASIA - MMILLS AND JLEICHTER
STATE FOR E, EB/IFD/OMA, AND EUR/SCE
NSC FOR MCKIBBEN
DUBAI PASS TREASURY - DLOEVINGER

E.O. 12958: DECL: 09/15/2008

TAGS: [EFIN](#) [PGOV](#) [PREL](#) [TU](#)

SUBJECT: POST THOUGHTS ON DISBURSEMENT TIMING, MESSAGE TO
TURKS

[11.](#) (U) Classified by Deputy Chief of Mission Robert Deutsch
for reasons 1.5 (b) and (d).

[12.](#) (C) Summary: Ankara-based IFI officials have expressed concern that the timing of the U.S. disbursement of its financial assistance could create moral hazard by removing market pressure for implementation of reforms, just as the work of the Sixth Review is peaking. Although we would not say the GOT is "off track," it still has much work to do to comply with the Sixth Review requirements. Particularly because our actions on the first disbursement will set a precedent, as we proceed to sign the Financial Agreement, we should reiterate to the GOT our standards of evaluation of "strong economic policies," and make clear that our disbursements will require us to determine that the GOT is making appropriate, continuous progress on the reform program. Doing so will discourage a premature GOT disbursement request, and also enable us to reject any suggestion that we are moving the goalposts. End summary.

IFI (and Post) Concerns about Early Disbursement:

[13.](#) (C) Both World Bank and IMF officials based in Ankara have expressed concern that the first disbursement of U.S. financial assistance could undermine pressure for reforms, if it occurs when the IFIs are in the middle of negotiations with the GOT on reform implementation. A U.S. disbursement could create a moral hazard problem by overwhelming any market concern about failure to reform, thus preventing markets from sending the right message.

[14.](#) (C) Despite assurances the GOT policymakers finally understand the need to proceed with implementation, GOT behavior during the period since completion of the IMF Fifth Review has been no different than earlier post-review periods. Despite all the positive rhetoric, they have yet to demonstrate that they are going to move with any greater alacrity and enthusiasm to complete the Sixth Review than they did for the Fifth. The GOT track record remains one of pushing through reforms in a rush just in time to get delayed IMF Board approval of a review, and only when failure to do so would have significant repercussions in the market. The IMF's Sixth Review mission arrives in Turkey September 25 and is expected to stay through October 11. In the first half of October, we expect the GOT and the IMF to be in the thick of negotiations for implementation and corrective action.

Lots to Do for the Sixth Review:

[15.](#) (C) Since the Fifth Review, the GOT does not appear to have taken significant additional action on the reform program, although this can at least partly be attributed to the parliamentary recess. In a meeting with Econoffs September 18, IMF ResRep Odd Per Brekk was careful not to say the GOT is off track, but outlined the considerable work still to be done for the Sixth Review:

--SEE's: A Treasury official admitted to Econoffs that the GOT had reduced the number of redundant SEE employees by only 11,000, far from the 19,000 end-September target. The IMF ResRep did not feel the record was all negative, however, since the program's strategy seems to be working, albeit more slowly than anticipated. The key will be whether the government has the political will to lean on the SEE managers to further reduce staff.

--Public Financial Management and Control Law: The ResRep was optimistic it would be passed by Parliament, though, of course, he could not say for sure whether it would be passed by the end-October target date.

--Direct Tax Reform: It remains controversial and politicized, with considerable GOT resistance--up to the Prime Minister--to eliminating all the regional tax incentives. Though the Sixth Review will not require passage of the Direct Tax Reform, it will require GOT agreement with the Fund on the specifics.

--Legislation to strengthen the BRSA's hand in dealing with court cases involving problem Banks: It has been prepared but parliamentary passage will also be needed for the Sixth Review. Comment: Given the Imar Bank controversy, there may be some debate. End comment.

--Privatization: The Sixth Review requirement of approval of a plan to privatize Turk Telekom appears to be on track, according to Brekk, though the Council of Ministers has yet to formally approve the plan. Though the indicative privatization proceeds targets will be missed, the Privatization Authority seems to be moving ahead on the Tekel, Tupras, and Petkim privatizations. (Post will be reporting more on privatization in the coming days).

--Growth and inflation targets: Brekk said current trends suggest Turkey will reach the year-end target of 5 percent real GDP growth and at least come very close to the 20 percent inflation target. Lira interest rates are in line with Fund projections.

--Fiscal target: Brekk and his deputy, Christoph Klingen, insisted they still did not have clarity on January-August fiscal performance. Klingen said that he and the IMF's fiscal economist--due in Ankara in a few days--need to go over the numbers in detail with Finance Ministry officials before making any firm judgments. Brekk admitted, however, that the GOT probably missed the end-August primary surplus target by a small amount, though the GOT says it remains committed to the 6.5 percent year-end target. Brekk also felt that, if the GOT missed that target, it would only be by a small amount, not the 1.5 to 2 percent of GNP suggested by some analysts.

U.S. Message:

16. (C) Today's daily newspaper "Milliyet" carries Babacan's warning that the U.S. and Turkey might not sign the FA in Dubai the week of September 22, saying "we cannot say everything is on track" in reference to Congressional requirements of conditionality. This comment is in keeping with Babacan statements earlier in the year that the U.S. might pull surprises or impose new conditions.

17. (C) We have been clear all along that we were going to condition this money on strong implementation of reform, and we need to remind Babacan that this has been our position all along, and continues to be our position. This should be our strong message to him in upcoming meetings. As Washington knows, over the next 18 months our money will exceed by far any net cash flow from the IMF. The first disbursement is an opportunity to set a positive precedent that a) we aren't playing games or coming up with new conditions, but b) fully intend to use this money to encourage sound policies and reform. If we are going to require something approximating completion of the Sixth Review requirements before disbursement, which we believe is the right approach, it is critical that we let the GOT know this now, so as to avoid a premature GOT disbursement request or any suggestion that we are moving the goal posts.
EDELMAN